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SUBJECT: AUSTRALIA PLAYS HARDBALL WITH TELECOM GIANT

1. (SBU) SUMMARY. The Rudd government is seeking to force Telstra, Australia's leading telecommunications company, to restructure or risk losing access to any future mobile spectrum. The government is confident that Telstra will negotiate and split its operations. Market analysts seem to agree that if the GOA is serious about the plan, Telstra stands to lose less by negotiating. Telstra shareholders could pose a political cost if the government is perceived as being too tough on the company. Overall, the measure is seen as a necessary step to increase competition in Australia's telecommunications industry. END SUMMARY.

Separation = Increased Competition

2. (U) Communications Minister Stephen Conroy sought to reduce Telstra's dominance of the telecommunications industry by giving Telstra 15 weeks to decide whether to remain an integrated company or accept to split into less dominant retail and wholesale companies - forcing the sale of its cable network Foxtel (50% stake) and the associated hybrid fiber optic network that carries broadband and pay TV. Telstra can choose to remain integrated, but would lose access to any future mobile spectrum.

3. (SBU) Industry group Competitive Carriers Coalition (CCC) Executive Director David Forman, who met with Minister Conroy the day before the announcement, told Econoff that Conroy felt very confident that Telstra would negotiate. According to Forman, Conroy aims to get Telstra to negotiate by December, since he did not want to drag out the negotiations into an election year. While CCC is somewhat worried about a lack of transparency in the GOA-Telstra negotiation process, Forman remains fairly confident that Conroy will ultimately deliver on his plan, noting that "Conroy has been consistent all along."

4. (U) The government believes that Telstra would be too dominant if given a major share in its planned A\$43 billion National Broadband Network (NBN) without structural separation - since it would have vertical integration and dominance of both the copper (local call) and fiber (broadband) networks. The Australian Competition and Consumer Commission (ACCC) said the separation would constitute a telecommunications revolution. It would also strengthen the ACCC's position of trying to impose pricing settlements on the company. According to Australian number two telecom company Optus, the telecommunications industry spent more than A\$200 million in numerous legal battles against Telstra's efforts to stifle competition -- Telstra would use delay tactics to slow third parties from gaining access to its network.

To Split or Not to Split

15. (U) Telstra chief executive officer David Thodey considers that government threats to remove his company's access to mobile spectrum are "unnecessary and need never be implemented" - suggesting that the company could acquiesce to the government's demands to avoid sanctions. Deutsch Bank estimated the cost of a split to Telstra to be around A\$2.5 billion, whereas rejecting a split, which would include losing access to mobile spectrum, could cost A\$3.1 billion.

16. (U) Moody's Standard & Poor's placed Telstra under review, noting the considerable uncertainty about the proposed changes to its structure. Other analysts said that by agreeing to voluntarily Qits structure. Other analysts said that by agreeing to voluntarily separate key network assets from the rest of its operations, Telstra could reduce debt, lower capital expenditure, protect its customer base and focus on faster-growing parts of the industry.

17. (U) The Rudd government could pass separation legislation without Liberal party support given that The Nationals, Australian Greens and one independent senator have indicated support. However, Telstra's 1.4 million shareholders, who, stand to be major losers in this process if Telstra stock decreases much in value, could pose a political cost if the government is perceived as being too tough on the company. The Australian Shareholders Association dismissed Conroy's suggestion that there would be a "win-win" outcome.

18. (SBU) COMMENT: While there remain considerable legal, administrative and political obstacles to overcome, this could be a major boost to competition in the telecommunications sector. There is a view that Telstra is essentially being blackmailed into handing over its fiber optic network to the NBN. On the other hand, Telstra

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may be the only telecom with the economic might, infrastructure and customer base to be a significant co-investor in the NBN. Although the government holds the upper hand in negotiations, it must still proceed with caution as not to "kill the goose that lays the golden egg."